RATE FILING UNDER THE FLEX RATING SYSTEM

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RATEMAKING SEMINAR

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The topic that I am going to speak about deals with making a rate filing under the flexible rating system. Flex-rating is a concept that was introduced with the enactment in New York of the Omnibus Insurance Legislation of 1986. Prior to this, there were two filing methods in New York - prior approval for private passenger automobile, workers' compensation and most types of medical malpractice, and open competition, i.e., file and use, for the remaining lines. As a result of the liability crisis, and a reluctance to impose prior approval for lines not previously so subject, the compromise position of flex-rating was created. Under this system, rates for certain commercial liability markets may be changed without prior approval, as long as the resulting rate falls within a specified range, called a flex-band, applicable to that insurance market.

Webster's defines the word "flexible" as, "capable of responding or conforming to changing or new situations." I am sure that many of you feel that the title of this new method of regulation is a total misnomer. After all, lines of business previously free of almost all state scrutiny and modifiable almost at whim, are suddenly subject to a whole array of new guidelines and regulations. How could the imposition of additional requirements be described as flexible? Part of my job here today is to reassure you that, in fact, the Department's goal in implementing flex-rating was to preserve as much of the spirit of competition as possible while at the same time enabling it to effectively monitor the insurance market place.

How does the system really work?

Flex-bands are defined for the various lines of insurance for both overall rate level change and for individual insureds' rate changes. Overall rate changes without prior approval can vary from $\pm$10% to $\pm$30% within a twelve month period, depending on the line. These bands will be periodically reviewed by the Superintendent. Individual rates, in addition to any average change, could reflect revised class, territory and/or increased limit relativities. An individual rate change cannot exceed the overall change by more than 20% in either direction. There is a maximum of three rate changes per twelve month period, which if they remain within the flex-band would not be subject to prior approval. If a filing does not exceed the flex-band then it may be used before the Department passes judgment on it. This does not mean that the Department does not review the filing or follow through with any questions or concerns it may have vis-a-vis the filing. If a filing exceeds the band then it must be approved by the Department before it can be implemented by the insurer. This is not to say that the filing will not be approved, just that the rates cannot be used until they are. During 1987, the first full year that flex-rating was in effect, the Department received 961 rate filings which were subject to the provisions of flex-rating. Over 850 of the filings were within their flex-band; of the 108 that exceeded the flex-band, 80 were approved as filed, 15 disapproved and 13 were still pending at year's end.

If the great majority of filings get approved anyway what does flex-rating accomplish? First, it enables the Department to concentrate on those filings that appear to require "large" rate changes. One of the purposes of flex-rating was to smooth out the peaks and troughs of the underwriting cycle. Monitoring those insurers whose needs appear to exceed the expected, assists in smoothing the cycle. Secondly, companies will be encouraged to carefully consider their rate request and to determine what their real rating needs are before they file for huge revisions.

What to include in Rate Filings

1. -Investment Income: Section 2303 of the New York Insurance Law requires consideration of investment income in determination of all rates, those subject to prior approval and those subject to file and use. While the question of how investment income should be included in ratemaking is a subject of great controversy, the law requires that it should be reflected. In general the Department does not specify methodologies to be used when making a rate a filing, and is willing to review any innovative approaches.

2. -Trend Factors: Trend factors should be coverage appropriate. If a company is proposing to use a trend that is significantly different from the industry average, then supporting information is necessary. When individual company data are not credible, industry data or other economic indicators should be used.

3. -Loss Development Factors: Ideally individual company loss development factors for New York State should be submitted along with the filing. However, if credibility is an issue, country-wide data or even industry data for New York could be substituted.

4. -Underlying Data: The data accompanying the filing are the basis for the Department's evaluation. Therefore, the data should be as complete as possible. Premiums should be on current rate level. Losses should be developed and trended. Calendar year data should be avoided for long tail lines. Whenever possible, basic limits data should be used as opposed to total limits. Individual large losses should be identified. Data prior to August, 1986, should reflect the impact of Tort Reform.

Conclusion:

Flex-rating is scheduled to expire June 30, 1988. Legislation has been proposed to extend this system until 1994. At this point it is still too early to tell whether flex-rating has indeed stabilized the insurance marketplace. However, the Department hopes that over the course of the next few years flex-rating will assist in providing affordable and available insurance products for New York consumers.

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